BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

MARC SPITZER, Chairman
JIM IRVIN
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
MIKE GLEASON

In the matter of ***GOLDMAN, SACHS & CO.*** ***85 Broad Street*** ***New York, NY 10004*** **CRD # 361** Respondents.	))))))))))))	DOCKET NO. S-03533A-03-0000 DECISION NO. 66318 **ORDER TO CEASE AND DESIST, ORDER FOR ADMINISTRATIVE PENALTIES AND CONSENT TO SAME BY: GOLDMAN, SACHS & CO.**

WHEREAS, Goldman, Sachs & Co. ("Goldman Sachs") is a broker-dealer registered in the State of Arizona; and

WHEREAS, coordinated investigations into Goldman Sachs's activities in connection with its potential conflicts of interest by research analysts, the issuance of research that might have lacked objectivity, and potentially improper sharing of research information with public companies and the investment banking division of the firm during the period of approximately 1999 through 2001 ("Relevant Period") have been conducted by a multi-state task force and a joint task force of the U.S. Securities and Exchange Commission, the New York Stock Exchange, and the National Association of Securities Dealers (collectively, the "regulators"); and

WHEREAS, Goldman Sachs has cooperated with regulators conducting the investigations by responding to inquiries, providing documentary evidence and other materials, and providing regulators with access to facts relating to the investigations; and

WHEREAS, Goldman Sachs has advised regulators of its agreement to resolve the investigations relating to its research practices; and

WHEREAS, Goldman Sachs agrees to implement certain changes with respect to its research practices, and to make certain payments; and

NOW, THEREFORE, the Arizona Corporation Commission ("Commission") hereby enters this Order:

I.

JURISDICTION/CONSENT

GOLDMAN SACHS elects to permanently waive any right to a hearing and appeal under Articles 11 and 12 of the Securities Act of Arizona, A.R.S. §44-1801 *et seq.* ("Securities Act") and Title 14 of the Arizona Administrative Code with respect to this Order To Cease and Desist and Order for Administrative Penalties ("Order"); neither admits nor denies the Findings of Fact and Conclusions of Law contained in this Order, and consents to the entry of this Order by the Commission.

II.

FINDINGS OF FACT

1. As set forth in greater detail herein, in general, during the Relevant Period, certain of the procedures and processes in place to insulate Goldman Sachs's equity research analysts (hereafter "analysts" or "research analysts") from pressures and influences from covered companies or investment banking were not sufficient. Also, in general, during the Relevant Period, in some respects Goldman Sachs failed to exercise reasonable supervision so as to ensure that, in the context of the procedures and processes in place, its research analysts were sufficiently insulated from pressures and influences from covered companies or investment banking.

2. Goldman Sachs is a leading global investment banking and securities firm that, among other things, offers underwriting services to companies seeking to sell their securities to the public. In addition to its prominent investment banking operations, Goldman Sachs also offers extensive services to its institutional investor clients and its private wealth

management clients (principally high net worth individuals), has an active securities sales and trading business, and maintains a separate division to perform research on equity securities.

3. For the companies for which Goldman Sachs provides equity research coverage, Goldman Sachs analysts issue periodic reports and make investment recommendations. During the Relevant Period, Goldman Sachs's equity research ratings included four investment ratings:

Recommended List - expected to provide price gains of at least 10 percentage points greater than the market over the next 6-18 months;

Market Outperformer - expected to provide price gains of at least 5-10 percentage points greater than the market over the next 6-18 months;

Market Performer - expected to provide price gains similar to the market over the next 6-18 months; and

Market Underperformer - expected to provide price gains of at least 5 percentage points less than the market over the next 6-18 months.

In addition, Goldman Sachs had one shorter-term rating:

Trading Buy - expected to provide price gains of at least 20 percentage points sometime in the next 6-9 months.

4. In addition to ratings, the research reports generally contained Goldman Sachs's analysis of the covered company's financial prospects.

A. INVESTMENT BANKING DIVISION'S RELATIONSHIP TO AND INFLUENCE ON RESEARCH DIVISION.

Portrayal of Research

5. Goldman Sachs held itself out as generating and providing research reports that were the product of objective research and the opinions of the firm's research division. During the Relevant Period, Goldman Sachs disclosed various conflicts of interest-related disclaimers

in its research reports, including investment banking relationships with covered companies.

6. The research reports and ratings of companies covered by Goldman Sachs analysts as well as Goldman Sachs's list of recommended stocks were made available to Goldman Sachs's institutional investor clients and its private wealth management clients, principally high net worth individuals. On occasion, the substance of Goldman Sachs's research reports, in whole or in part also was reported in the U.S. financial news media.

7. Goldman Sachs's equity research included formal, so-called "blue-stripe" reports, notes, and comments.

8. Goldman Sachs's research or the content of its research was disseminated by various means, including: by mail, via facsimile, distributions at client meetings, via e-mail, via Goldman Sachs's research Website for clients, telephone conversations by analysts and salespersons, and as part of analysts' appearances on television, at seminars, and at industry conferences.

9. The 2002 mission statement by Goldman Sachs's U.S. research department was: "Regain our pre-eminent status through independent, high-quality, differentiated product and service."

<u>Research analyst assistance to investment banking.</u>

10. During the Relevant Period, research coverage by analysts (including at Goldman Sachs) was a factor many issuers took into account in awarding investment banking business. The reputation of Goldman Sachs's analysts was sometimes a factor in winning investment banking business from certain issuers. Goldman Sachs's use of its research analysts for investment banking business went beyond simply relying on the reputation of its analysts; Goldman Sachs's research analysts assisted in evaluating and marketing certain investment banking business.

11. Frank Governali, co-head of Goldman Sachs's research for the telecommunications sector, joined Goldman Sachs in mid-1999. In January 2000, he e-mailed a former colleague at

another investment bank: "It's been a good first 6 months, and its [sic] been very busy. There has not been a day when we're not involved with some deal, so I'm learning a lot more about that side of the business than I experienced at [the other investment bank]."

"Research alignment" process

12. In connection with making coverage decisions in the context of limited resources, Goldman Sachs implemented a Research Alignment process whereby the Investment Banking Division, the Equities Division, and the Research Division "work collaboratively to insure a strategic alignment of [Goldman Sachs's] business - that the biggest opportunities for investment banking and equities were being covered, that [Goldman Sachs] had the right Research resources in the right places, and that [Goldman Sachs's] Research reputation for independent and thoughtful analysis was sustained if not enhanced." In the context of Investment Banking, Research Alignment "insur[es] that companies of strategic and/or commercial importance to both IBD and Research are covered by an analyst and a banking team. . . . [I]deal candidates for coverage are those that are franchise defining, and/or those that offer a meaningful opportunity for significant revenue in the relatively near term."

13. Sector captains were appointed within investment banking to "coordinate *all* banker requests for Research coverage; work with IBD teams and ECM [Equity Capital Markets] to establish priority rankings within the sector and reach consensus with Research counterparts."

14. A January 2001 research retreat reminded analysts that investment banking sector captains were to "[w]ork directly with Research counterparts to agree on names and timing" of companies to be covered and to "[d]etermine IBD priority ranking of *each* company needing Research, including rationale and timing."

15. Representatives of investment banking and research met periodically to review companies that were candidates for research coverage. In May 2000, the heads of research reported: "Of the 63 companies highlighted which offered equity opportunities over the next 12

months or which were SuperLeague targets, 40 are now considered no longer active, 9 have been picked up by Research, and 14 still need coverage, based on recent banker input . . . ."

16. The Research Alignment process was designed to ensure that the various interested areas of the firm (including Investment Banking and Equities) had effective input into which issuers to cover and when to initiate coverage. Goldman Sachs states that the research alignment did not dictate the substance of research.

Goldman Sachs's compensation structure and employee performance review system

17. As with all professional employees of the firm, analyst compensation consisted of a salary and a discretionary bonus. Analyst compensation at Goldman Sachs was based on many factors, including, among other things, the level of compensation that analysts could command in the market for their particular industry or sector specialty - which might be impacted by the level of investment banking activity in that sector - whether an analyst was ranked in broker polls, *Greenwich Survey, Institutional Investor,* and performance reviews - which, as discussed below, often made reference to contributions to investment banking. Analysts received no formulaic or other compensation with respect to specific investment banking projects. Comments in some employee evaluations indicated that some analysts were involved in many aspects of investment banking-related activities and reflected certain employees' beliefs that participating or assisting in investment banking activities was a factor in measuring the analyst's performance.

18. Goldman Sachs introduced a new program in June 2000 to strengthen "firmwide marketing . . . including how we leverage our brand, advertise, and in particular, cross-sell . . . ." Strengthening cross-selling efforts was defined as a "top strategic priority for 2000." A $50,000 award was created to recognize individuals across all divisions of the firm who "cross-sell or help deliver a significant mandate to another business unit or division."

19. Goldman Sachs explored and took steps toward the development of a potential "Analyst Scorecard" in 2001, to measure the success of analysts' work, including "client contact and

revenue generation," and "the analyst's involvement with IBD transactions, and associated fees [to be earned by Goldman Sachs]." In connection with this process, Goldman Sachs created spreadsheets, for each analyst, listing the number of investment transactions in which the analyst was involved and the total value of investment banking fees involved in those transactions. Goldman Sachs determined not to implement the Analyst Scorecard. Had Goldman Sachs decided to implement the Analyst Scorecard, the investment banking deals with the largest estimated revenues to Goldman Sachs would have resulted in higher scores on the Analyst Scorecard.

20. In February 2002, Goldman Sachs introduced its Research Pentathlon. There were five areas being measured: polls, stock picking, commercial, reviews, and culture. As part of the commercial measurement: "analysts [were] measured according to their banking and trading activity." Each analyst was required to identify those "announced or closed banking transactions in your sector that took place" during the prior period. For example, in a February 15, 2002 e-mail, an analyst was told to indicate whether he had "Introduced Senior Management to GS Banking," "Attended Pitch," or "Led Sales Call," and to "rate the scale of your overall involvement" ranging from minimal to critical.

21. All Goldman Sachs employees, including analysts, were evaluated as part of the firmwide "360 degree" review process. During the Relevant Period, analysts, like all other employees at the firm, were evaluated not only by supervisors, peers, and subordinates in the research division, but also by employees in other divisions and departments of the firm with whom the analyst had worked, including to varying extents investment banking and equity sales and trading. The evaluations that employees submitted during the 360 degree review process generally were anonymous. In most cases, even the analyst's supervisor who orally delivered the year-end review to the analyst did not know the identities of the employees who made comments about the analyst. The specific comments in the 360 degree reviews were not shown to analysts but certain comments may have been discussed

or described in some cases. Rather, after reading all of the 360 degree reviews, reviewing other indicators of performance and taking into account his or her own assessment of the analyst's performance, the analyst's supervisor would provide an overall assessment of the analyst's performance.

Comments about analysts in the 360 degree review

22. Some employee evaluations referred to investment banking revenues on transactions in which the analyst had a role and to the fact that analysts might be involved in many aspects of investment banking.

a. For example, one employee commented that an analyst was: "Very hard working, focused and eager to do a good job and win business." He said the analyst was "Becoming much more proactive about sharing info with banking. A good team player and very cooperative. Well focused on banking issues and GS [Goldman Sachs] business overall." Another evaluation of the same analyst commented that: "He is a great help to the Banking franchise. Always willing to impart his expertise and seems happy to take the time to explain complex strategic and positioning issues." A different evaluation of this analyst stated: "[Analyst] takes a high level of pride in his analysis and work, and has put out a number of carefully researched and well-written pieces which are definitely value-added to clients."

b. An evaluation of another analyst stated: "She did a super job with the IB client as well as investors on the Coinstar CSO. . . . She became more comfortable over time that IB fee-paying potential should be a consideration in her list [of companies to cover]. Though [analyst] worked closely with IB putting her initial list together, [analyst] is fairly (sometimes fiercely) independent. I strongly suggest that she use the resources that IB offers as she works evaluating companies (e.g. when changing her [financial] model, please inform/consult the IB team)."

c. A comment about one analyst stated: "Hard to say how much of poor investment decisions have been because banking drove the outcome." Another comment about the same analyst said: "[Analyst] has a very high integrity in her work."

d. An evaluation of Frank Governali stated: "Frank is swamped and needs help. The demands placed upon him by his banking duties threatens the very franchise that has allowed him to become such a powerful banking asset. Frank is a very good analyst who is thoughtful, user friendly, creative and totally inaccessible." Another evaluation of Governali stated "his overall integrity is a strong feature."

e. An evaluation of another analyst stated: "There are still times when [analyst] does not think commercially about a client. There have been times when [analyst] is going to see an important CEO target and no one from banking is even aware that he has the meeting." Another comment about the same analyst said: "His analysis is considered very objective and is widely used by clients."

Performance evaluations influenced compensation.

23. Training for new analysts taught that their performance evaluation criteria included "Revenue production . . . [and] 360E feedback from IBD bankers."

Analyst business plans.

24. During the Relevant Period, analysts were required to develop business plans that discussed a broad range of areas such as what the analyst's plans were for Global Research with respect to both products and services, what major investment themes the analyst would develop relating to his or her coverage universe, and what investor conferences the analyst had planned. One of the many such categories covered by the business plans was how the analyst planned to assist the investment banking efforts of the firm. As noted below, the business plans included questions that implied that the research analysts' contribution to the firm's investment banking business plan was part of their job. Business plan forms asked analysts to explain, among other things:

a. "How much of your time will be devoted to IBD?"

b. "Are you using/managing IBD effectively? How can you work more effectively with IBD to exploit the opportunities available to the firm? What specific opportunities do you see? Do you have alignment - do you have counterparts in IBD you work with to approach business in an integrated fashion? How can IBD help you in conferences, client meetings, etc?"

c. "What stocks do you plan to add at current team size? . . . Have you discussed this coverage with relevant IBD, Equities and other users?"

d. "With which corporates do you have a better relationship with senior management than IBD does? How will you use that to enhance GS business opportunities?"

25. Analyst responses included:

a. In response to the question: "What are the three most important goals for you in 2000?" one analyst replied: "1. Get more investment banking revenue. 2. Get more investment banking revenue. 3. Get more investment banking revenue."

b. Another analyst commented: "My two most important company specific research reports in 2000 will likely be the initiation of coverage reports of the two Latin American e-Finance companies that we may IPO this year." [An IPO is an initial public offering.]

c. An analyst expressed the view that "flexible/opportunistic research can be a *big* business driver for GS." In discussing "Lessons Learned," the analyst also stated that: "Reputational issues surrounding this business demand that we properly manage it" including "Independence of Research."

d. In response to the question of which firms present the toughest competition to an analyst and what the competition does better, one analyst remarked about the firm Sanford Bernstein: "Bernstein also gives us a run because they have equivalent manpower to what we have, but they cover only about half as many stocks and don[']t have any banking business. We just have an incredibly difficult time beating the thought leadership these guys are able to put back on the table as a result of that focus."

Analysts' assistance to investment banking.

26. An August 2001 presentation to managers of the research division on Research Alignment states: "The individual company coverage provided by Global Investment Research helps drive the majority of the firm's largest businesses, from winning financing deals and advisory business to obtaining orders in the secondary market." The presentation also states: "the Research Alignment process was developed with the goal of quantifying, at the individual company, industry and sector levels, the available revenue opportunities to Goldman Sachs on both the Equities (trading) and IBD (equity issuance, high yield issuance and M&A) sides of the business." On the investment banking side, this assistance included, among other things, identifying potential investment banking opportunities, assisting in pitching investment banking business, and assisting in selling securities being underwritten by Goldman Sachs.

27. Analysts assisted investment banking at the firm by using their knowledge of particular industry sectors and companies within those sectors to identify potential investment banking opportunities.

28. An analyst wrote to an investment banker, wanting to "harmonize with you strategically" to pursue an investment banking opportunity with one of the companies in the technology sector that the Research Division wanted to cover. The analyst suggested offering research coverage of the issuer to be in a position to obtain investment banking business.

29. A widely distributed 2001 e-mail discussed "an *Internal Use Only* report for Investment Banking in the Americas highlighting Research views on potential investment banking activity in each sector." The "report will provide our bankers with a record of our ideas, and credit when our prescience leads to a transaction."

30. In October 1999, an analyst sent an e-mail thanking equity salespeople and private wealth

management representatives at Goldman Sachs for arranging investors for a non-deal roadshow for company management to present a potential share repurchase to potential investors. The day after the roadshow was completed, the company awarded Goldman Sachs a mandate to repurchase 5% of the company's outstanding stock. The analyst told the salespeople and private wealth management representatives: "your efforts have already borne positive fruit" because "Goldman Sachs received the mandate for [this share repurchase] as a direct reward for the work you all did."

Assistance in making pitches.

31. In an April 20, 2000 e-mail, an investment banker told two analysts at the firm that in preparation for an investment banking pitch to a potential issuer [Loudcloud], that the company suggested that the analysts "come prepared to SELL." The banker proposed that part of the pitch include a draft research report on the potential issuer so that Goldman Sachs could say "we are so excited about the story that we have already begun writing the report." The analyst predicted to the investment bankers: "WE WILL WIN THIS MANDATE!!!"

32. Frank Governali was credited by a Goldman Sachs banker as the determining factor in winning an early 2000 IPO for a foreign issuer: "Frank was fully involved in pitching this and thanks to him, we received a sole-book mandate with Joint lead of [another investment bank]." Moreover, the banker told other analysts "your input will be critical to the success of this IPO."

Assistance in explaining and marketing IPOs to institutional investor clients.

33. Analysts often assisted in marketing the securities to be sold in an IPO. One issuer's "Lead Banker Selection Criteria" stated: "Need to understand commitment of senior analysts that they will be the 'lead' research analyst on the deal and in the aftermarket." This "commitment" was understood to include the following with respect to analysts:

a. "Spending time personally with the CFO to refine the financial model and define appropriate IPO and ongoing business metrics."

b. Assisting with the roadshow presentation.

c. "They personally will pro-actively market [the issuer] to the institutional community and be available on a regular basis to respond to institutional investor questions."

34. A March 2001 pitchbook stated: "Leverage the role of research in marketing the [issuer's] story."

35. An analyst commented about an issuer: "I have been out aggressively telling the story, and the volume has picked up noticeably." The issuer's stock had moved from $50 on August 2, 2000 to over $60 on August 25, 2000, the day of this e-mail.

36. Responding to complaints by a potential issuer about a downgrade of the sector, an analyst told the potential issuer: "Both [analyst] and I continue to view the [potential issuer] offering in these difficult markets [as] our highest priority, and remain committed to doing everything we can to get us to a successful outcome over the coming days and beyond. . . . We continue to use every opportunity including client discussions of the macro environment to highlight [potential issuer's] short and long-term differentiation against a lot of the public models." The analyst closed by saying: "Again, I want to stress that both [analyst] and I remain committed to the short and long-term success of [potential issuer]."

The time and effort expended by analysts to assist investment banking efforts varied.

37. In self-reported time estimates for 2000, one analyst estimated he spent 40% of his time on investment banking-related activities while another analyst estimated his investment banking-related activities consumed 55% of his time.

38. Business plans prepared by analysts included an estimate of how much of the analyst's time not devoted to Research would be devoted to each of four divisions of the firm, including Investment Banking and Equities. In 1999, different analysts estimated they would spend between 5% and 75% of their non-Research time on Investment Banking, which included all merger and acquisition and financing activities (dividing 100% of their non-Research

time among the four divisions listed in the question).

Research alignment effectiveness.

39. Goldman Sachs's "Global Investment Research IBD Alignment Process" was summarized as follows in 2000: "US Investment Research appears to be on the right track with our IBD alignment initiative."

a. "[R]esearch analysts, on 429 different occasions, solicited 328 transactions in the first 5 ½ months of this fiscal year."

b. "Research was involved in 82% of all 'won business' solicitations."

c. "Research was involved in 49% of 'lost business' solicitations."

d. "Only 4.3% of all IBD 'lost business' was attributed to lack of research coverage."

e. "IR [Investment Research] was involved in 31 mergers amounting to $56 billion."

f. "IR was involved in 209 financing transactions not reported in MarketView amounting to $83 billion."

g. "In addition to financings, US IR was involved in a significant number of merger advisories, solicitations, and other transactions which have either not yet closed or were not captured [in the] database."

Influences of investment banking personnel on research and the timing of research coverage.

40. In at least some instances, analysts sent drafts of research reports to investment banking before publicizing them. An advance copy of changes to a research report was sent to two employees in the investment banking division for their comments "to speed up the approval process."

41. One analyst stated in a business plan: "Since our banking ties are so close to each one of the companies mentioned above along with the fact that these companies are direct competitors with each other, it is incredibly difficult to voice strong opinions in these sectors."

42. In early 2000, Goldman Sachs investment banking client "Ask Jeeves" expressed concern

that Goldman Sachs had yet to initiate research coverage on the issuer. The issuer e-mailed Goldman Sachs's investment banker saying its stock was "dropping like a rock," and stating: "Our hopes were that a buy coverage from our lead banker might help stabilize the stock." Goldman Sachs's investment bankers complained to analysts who stated that "[w]ith research commitment committee approval and an improvement in the market, research coverage is imminent."

Discussion of research capabilities in Goldman Sachs pitchbooks.

43. Some Goldman Sachs investment banking pitches included a discussion of the benefits the issuers would receive from Goldman Sachs research. In some cases, this included reference to Goldman Sachs research ratings for other companies covered by Goldman Sachs analysts.

Examples of pitches featuring the roles of analysts

44. An October 2000 pitchbook for GeneProt explained the "[r]ole of investment research analyst," as "creating the story . . . marketing the story . . . [and] following the story." A pitchbook for MFS Investment Management included a list of the various ratings provided by the analyst on the companies he covered, stated a "[g]lobal sales effort led by analysts," and contained a diagram of the role of analysts in an initial public offering.

45. A July 2000 pitchbook to Crown Castle said "Goldman Sachs has been a constant bull on the tower sector" and stated the fact that "Goldman Sachs has placed Crown Castle on our Recommended List, our Firm's highest investment rating."

46. Another pitchbook said: "[Goldman Sachs analyst] has sold more stock than any research analyst in the sector." The pitchbook provided a list of other companies covered by the analyst - none had a "Market Underperformer" rating, eight had Market Performer ratings, four were listed as Market Outperformers, and five were on the firm's Recommended List.

Goldman Sachs's investment bankers had input into research coverage decisions.

47. Investment banking and equities personnel had input into decisions regarding the initiation

and termination of research coverage for certain issuers.

48. On July 12, 2000, Goldman Sachs assigned a Market Outperformer rating for RSL Communications. By October 11, 2000, the stock had dropped below $1.50 so the analyst sent an e-mail to Frank Governali asking when Goldman Sachs could drop coverage of RSLC. Governali responded: "Good que[s]tion. I'll Call the bankers soon and ask their view."

49. An investment banker informed an analyst in 2000 that the head of research had approved "dropping coverage of Olympic Steel (ZEUS) and Birmingham Steel (BIR)."

50. In September 1999, an investment banker sent an e-mail to an analyst stating: "Our list for you to publish on from the IBD front is (in order): . . . ." Five issuers were then listed (four of which were investment banking prospects).

51. A 360 degree review of one analyst stated: "Initiated coverage of . . . [two examples cited] promptly after being co-manager on the initial public offering. NOT picking up coverage of [another company] as the company stiff-armed IBD when selecting underwriters."

52. In another 360 degree review of an analyst, an investment banker stated: "we have probably pushed her into research on companies where maybe she shouldn't have been or we did not have the client firmly commit[ed] enough on business before she covered them."

53. In 2001 an investment banker attempted "to squeeze [an analyst] about accelerating the time frame for picking up [coverage on Time Warner Telecom]."

<u>Analyst discussions about research.</u>

54. In March 2001, an analyst told her supervisor [Governali]: "I don't feel comfortable going on the call and pounding the table when I just can't come up with a way to justify the fact that [MFNX is] trading at 13 times 2001 revenue and I can't think of any catalysts except that it's fundamentally one of the best positioned companies out there and it's reaffirmed [its earnings] guidance." Governali responded to the analyst: "If you can't recommend it now, when it is trading at nearly all time lows[, t]hen it should be pulled from the

recommended list." The supervisor then listed multiple things the analyst could use to say good things about the issuer, concluding "while this stock may not soar in the next couple of months, it will probably bounce back a little, and over the next 12 months, significantly outperform. I'll call you in a bit." In the end, MFNX remained on Goldman Sachs's Recommended List until July - when the stock had dropped to $1.60 a share.

55. On July 21, 2000, Goldman Sachs was preparing to begin research coverage on Storage Networks. The analyst preparing the report said: "The [Discounted Cash Flow] tab of [the financial model] shows these revenues applied, and I cannot by any stretch of a variable come up with a stock price much if at all above the current levels." He asked his supervisor: "What do we want to do? assign a share scarcity premium? . . . Or do we just pick it up without a price target and an M[arket] O[utperformer]?" Four days later, Goldman Sachs initiated coverage with a Market Outperformer rating.

56. In August 2000, James Golob, the co-head of global telecommunications services, wrote Frank Governali, the other co-head, about the "anomalous situation where our sector has been tanking for 3-4 months and we globally still have a majority of stocks as R[ecommened] L[ist]s as that is all the salesmen and clients care about". Golob suggested that Governali at least consider the approach he had taken: "In Europe, we have found that honour is preserved if we have a stock as an M[arket] O[utperformer] and the companies can't complain because [it's] better than an M[arket] P[erformer]." Governali agreed, saying he planned "to re-rate most of the CLECs, which is where the problem is most egregious. The ratings were a residual from [a departed analyst], and I never changed them, not wanting to disrupt things too much. But, its ridiculous. I've already met with the bankers, and plan to move most of the companies down to M[arket] O[utperformer], from R[ecommended] L[ist] before [another analyst] takes over completely in September. . . . I don't think I would end up leaving only 7.5% as R[ecommended] L[ist], but the present 68% is ridiculous."

57. An analyst asked Governali in April 2001 whether she should adjust the "rating and price target" for 360 Networks since "it is clear that TSIX is worth 0." Governali suggested that rather than change the rating, they might "eliminate the price target." He expressed concern that: "Changing the ratings now is probably not a good idea, because from an outsiders perspective, who doesn't know anything, it may look like a belated ratings change . . . ." Governali was concerned that CNBC might "[make] fun of [the analyst] on the air."

58. In August 2000, the issuer Mpower was included in Goldman Sachs's Recommended List. At that time, Mpower's stock price was dropping rapidly. The analysts described the stock drop as "a death spiral." One analyst questioned whether the drop was due to investor concern over management at the company. The analyst covering Mpower, responded that the price drop was "just the stench of reality wafting through the air." The other analyst felt some vindication over the price drop, commenting that Goldman Sachs's investment bankers had maligned him "for lowering the [price] target from stupid heights to the merely absurd."

59. In May 2001, WorldCom had Goldman Sachs's highest rating. Governali told his counterpart in Europe that he "would have loved to have cut ratings long ago. Unfortunately, we can't cut [AT&T], because we're essentially restricted there. And without cutting [AT&T], there is no consistency in cutting WCOM."

60. Also in May 2001, Governali told his counterpart in Europe: "2001 estimates among sell side analysts, and company guidance, are still to[o] high for most companies, and long term growth rate assumptions are too high." He said: "As analyst and company expectations fall, we can get more positive again."

61. In May 2001, Governali apprised an investment banker that an analyst at another firm had just downgraded LVLT [Level 3 Communications]. Governali said he "share[s] many of the same concerns that this analyst has." At this time, and for another six weeks afterwards, Goldman Sachs maintained LVLT at its highest rating - Recommended List.

62. In a March 26, 2000 e-mail with the heading "GBLX [Global Crossing] - I think they are bullshitting us," an analyst stated that the company's revenue guidance "does not make any sense. . . . I think the answer is they wanted to obscure something sucking cash flow out of the company. . . . They are hiding behind the complexity of their accounting." The issuer remained on Goldman Sachs's Recommended List.

63. One analyst's self-evaluation in a the 360 degree review stated: "Has subordinated personal preferences on recommendations [citing two examples] for 'commercial' reasons."

Research ratings.

64. The percentage of issuers being assigned one of the top two investment ratings (Recommended List or Market Outperformer) ranged from 72% in the first quarter of 1999 to 50% in the last quarter of 2001. The percentage of companies assigned a Market Underperformer rating never rose above 1.1% during this time.

In some instances Goldman Sachs terminated research coverage on issuers without first having reduced its research ratings.

65. The number of companies for which Goldman Sachs ceased providing research coverage increased from one in early 1999 to 280 at the end of 2001. Some of these companies may have declared bankruptcy or ceased to exist during this period, while others were dropped because the covering analyst left Goldman Sachs. In some cases, Goldman Sachs ceased covering the company without first having downgraded its rating. A Goldman Sachs analyst asked whether this was the "proper protocol with respect to a bankrupt company."

Comments to institutional investors, internal observations.

66. Between July 1999 and July 2001, WorldCom had Goldman Sachs's highest investment rating - inclusion on the firm's "Recommended List." As noted above, the Recommended List rating means "expected to provide price gains of at least 10 percentage points greater than the market over the next 6-18 months." In April 2001 a hedge fund customer that had a short-term investment horizon asked Governali: "wcom . . . buy sell or hold here at

[$]20"? Governali responded saying: “sell.” Three months later, Goldman Sachs downgraded the stock one-step to a Market Outperformer rating.

67. In February 2002, a Goldman Sachs analyst rated Time Warner Telecom as a Market Performer at a price of $11.75. Again, this rating relates to a time outlook of 6-18 months. On February 21, 2002, the analyst was asked by another hedge fund that had a short-term investment horizon at what price he would then buy Time Warner Telecom, the analyst responded: “$0.25,” prompting a “wow” from the investor.

68. On June 21, 2001, the covering analyst downgraded the stock Exodus from a Recommended List rating to Market Outperformer. Both ratings have a time horizon of the next 6-18 months. Shortly before the downgrade, the analyst met with at least two institutional investors who e-mailed the analyst after their meetings:

a. An institutional investor wrote the analyst on June 21, 2001: “I wanted to write a quick email to you to THANK you for your candor when you came into our offices and gave me your teach-in on the company. You gave me the unbiased view, told me the negatives I needed to know - - and basically gave me the ammo I needed to prevent my PM from buying the stock [Exodus].”

b. Another institutional investor wrote the analyst the same day: “I really appreciate your straight forward comments on EXDS during our conversation last week. Looks like our worst concerns were realized yesterday. Fortunately, we were able to get out of our last piece at around $5 and avoid the recent carnage in the shares. Still painful, but it could have been a lot worse. . . thanks”

69. A comment about one analyst in a sales force survey said: “His investment recommendations have been abysmal and while I understand he communicates what he really thinks to a sele[c]t few, his public ratings have been an embarrassment to the firm.”

70. In the 2002 analyst review process, an investment banking vice president gave this evaluation of an analyst: “He also understands how to shade his comments to minimize the

impact of negative comments." Another commenter said about this analyst: "highly commercial yet maintains research integrity."

Draft research reports and expected research ratings were shared by analysts with issuers and Goldman Sachs's investment bankers.

71. Goldman Sachs's policy permitted management of covered companies to review draft research reports "as long as any response is limited to correction of factual inaccuracies or general indications as to the accuracy of projections." Analysts were instructed that "the analyst's recommendation paragraph, investment summary, as well as any references to other companies included in the report must be deleted prior to distribution to company management."

72. Goldman Sachs's policy further permitted analysts to give investment bankers and covered companies a "heads up" on the rating to be assigned to a company after the market closed the day before a report was to issue. "You may convey the conclusions of [pending research] to IBD/Companies outside trading hours. For example, you can alert bankers and companies just before the Morning Call that you are about to make a meaningful change."

73. In February 2000, an issuer whose securities were being underwritten by Goldman Sachs [Net 2000] was engaged in roadshow presentations to potential investors. During the roadshow period, an analyst sent Net2000 a draft financial model for the company. The issuer then complained to Goldman Sachs's investment bankers that the analyst "did not build a separate model for GS in support of our roadshow . . . [and n]ow our concern is that while GS's current estimates fit within our forecast, there is very little room for error. Specifically, I am requesting that GS estimate a $60M negative EBITDA instead of the current $57M. Our proposed estimate results in only a 10% cushion. I think this will ensure that everyone's interest and credibility is protected." The analyst changed the model to increase the negative EBITDA, but not as much as requested by the issuer.

74. In March 2001, one of Goldman Sachs's Hong Kong-based research analysts was preparing

to issue a sector report on the global underwater communications lines industry - predicting price erosion for companies in that business. An investment banker suggested that the Research Division get input from certain issuers "BEFORE this piece is published." Governali responded: "we wouldn't think of publishing this without direct input from the company and their review of the report."

75. In September 2000, following news of a possible merger between two large telecommunications providers, Governali wrote a research report on one of the companies. Because that company was on a list of companies for which Goldman Sachs was then providing advisory services (which could raise regulatory and other issues), he first "had to talk to our bankers and l[a]wyers before it went out."

76. Goldman Sachs initiated research coverage of Amazon.com on November 11, 1999. The previous day, an analyst sent to Amazon a "nearly final draft" of the initial research report. The draft did not include the rating to be assigned by Goldman Sachs, but did include the analyst's evaluative comments and his financial models about the company. Amazon responded with requests that the analyst change some phrases. Most of these comments were incorporated by the analyst before submitting the research report to the firm's compliance department.

77. Goldman Sachs initiated research coverage of Internet equipment provider Equinix on August 17, 2000. A draft of the research call note that omitted the price target and omitted the Market Outperformer rating in all places except one was sent to the company by the analyst on August 16 for comments before it was publicly released.

78. In an August 22, 2000 e-mail, copied to an analyst, an investment banker writes: "[analysts] had a meeting with [WebEx] yesterday (which I attended part of). We discussed initiation strategy and decided that likely to initiate (probably MO, no price target) shortly with a note to be followed with a report by end of next week (given additional info from yesterday's meeting and desire to iterate a bit with the company). [WebEx] was more than happy with

that approach as felt be beneficial to stock price to stagger good news.

79. On January 19, 2001, WebEx management wrote to the analyst: “As discussed, I want NO mention of any funding issues in this written report. I told you if people called and asked why your plan shows a need for modest funding, you can verbally tell them that management believes they have adequate funding and it is probably because manageme[nt] has a less conservative plan than you do.” The analyst responded, with an attached revised report: “The webx [sic] funding issues is a key area of investor concern, as such will remove any mention from the top section of the note, but will address it in a manner this [sic] is consistent with your recommendation for verbal responses to client inquiries in a later section. To exclude it completely detracts from the intention of the note, which is to address key investor concerns upfront and then give them a reason to buy the stock.” WebEx management responded: “Thank you. This is much better. The other note said the company has a funding problem, but we think it isn’t very big. This says that the company believes it has enough funds, but there could be a problem; and if there is it will be minor. Thanks again for the change.” The research report was issued on January 22, 2001.

80. In April 2001, an analyst sent a draft research report to Global Crossing Ltd. in advance of public release of the report. She received “extensive comments” from company officials. The analyst wrote Governali that she had “included [the issuer’s] extensive comments. . . I also said we had slightly smoothed the negative edge (emphasis section up front and text) from when they saw the report.” Moreover, the analyst said she “promised them I’d re-email the final report tonight so they could see our changes.” Despite all this, the issuer’s officers were still concerned and wanted to talk to Governali “so that ‘such an important industry report which is going to have profound implications’ will be to their liking.”

Goldman Sachs’s investment banking division had input into the hiring of Goldman Sachs’s analysts.

81. Recruitment of analysts involved input from investment banking among others.

82. In January 2000, an analyst and an investment banker stated that because Goldman Sachs's research resources were inadequate in a particular sector, they needed to "[h]elp prevent Goldman, Sachs & Co. from turning away substantial revenue business." They proposed that a European analyst be reassigned temporarily to cover the U.S. sector until a permanent analyst in the U.S. was hired.

83. In March 2000, Goldman Sachs was considering hiring an analyst from a competing firm. The day the candidate came to Goldman Sachs to interview, his first interview of the day was with an investment banker.

84. An undated Goldman Sachs chart listed analyst openings in each of the firm's research sectors. For each vacancy, the chart lists a corresponding "IBD Action Step." For the PC Hardware sector, research was ready to hire a candidate, but had to "[c]heck with IBD team . . . comfort level with proposed analyst experience." In the CommTech sector, there was "[c]oncern whether IBD will be comfortable with 'development time period' (i.e., bringing up to speed an internal hire and resulting suspension of coverage)." In Wireless Services, one offer had been extended but, because the offeree also wanted to bring with him to Goldman Sachs two associates and one assistant, "IBD approval [was] required for the junior team hire. Equities is OK." In the publishing sector, a targeted replacement had been identified, but "IBD approval required/confirm with [investment banker.]" For Taipei Head and CommTech, a written offer required "IBD approval."

B. GOLDMAN SACHS SUPERVISORY PROCEDURES.

Some supervisory procedures were in place, but contacts between investment banking and research were not adequately monitored.

85. Goldman Sachs's policy permitted analysts to "respond to generic requests for company or industry information from members of the Investment Banking Division. For all other requests, the analyst should ask the banker whether the request has been cleared by Research Management. If the request has not been cleared by Research Management, the

analyst must wait until the banker has the appropriate clearance before responding to the request."

86. In general, during the Relevant Period, Goldman Sachs failed to adopt sufficient procedures and processes to ensure that the interaction between research analysts and investment bankers or covered companies did not expose analysts to pressures or influences from investment banking or covered companies.

87. While one role of research analysts was to produce objective research, Goldman Sachs also encouraged some analysts to participate in investment banking-related activities. As a result of their participation in investment banking-related activities, those analysts were subject to pressures or influences from investment banking and covered companies. Goldman Sachs had knowledge of these pressures or influences yet failed adequately to manage them to protect the objectivity of the firm's published research.

88. Goldman Sachs's policies during the Relevant Period prohibited "convey[ing] the conclusion of pending research to anyone who does not need to know" (including bankers and covered companies), required that analysts only "disseminate material research . . . via a written product through the regular channels," and proscribed discussing "'material' pending research" which "could include initiations of coverage and changes in ratings, estimates, or price targets" with anyone outside the firm or investment bankers. On certain occasions, these policies were not consistently followed by analysts at the firm.

Some supervisory procedures were not adequate.

89. The procedures or mechanisms in place to monitor or supervise communications (including e-mails) between investment bankers and research analysts were not adequate. Similarly, the procedures or mechanisms to monitor or supervise communications between analysts and covered companies were not adequate. Additionally, there were inadequate procedures or mechanisms to restrict, monitor, or supervise e-mail communications sent by analysts from their home e-mail addresses.

C. <u>SUMMARY.</u>

90. Goldman Sachs portrayed its research as objective.

91. At the same time, the reputation and involvement of its analysts in investment banking activities was, at times, a factor used to solicit investment banking business. Analysts assisted in evaluating and marketing certain investment banking business. Goldman Sachs implemented a variety of programs that resulted in close cooperation between research analysts and investment bankers in certain aspects of their work. These included the research alignment initiative, consideration of investment banking comments in performance evaluations of analysts, development of business plans, a firmwide award for cross-selling, and analyst-created lists of investment banking transactions in their sectors. At times, analysts assisted investment banking by identifying potential investment banking opportunities, assisted in pitching investment banking business, and assisted in marketing securities being underwritten by Goldman Sachs.

92. Goldman Sachs research was subject to pressures or influences by investment bankers. At times, bankers were allowed to review and comment on research reports and pressured analysts about the timing to initiate coverage on specific issuers. At least one analyst felt it was sometimes difficult to voice strong opinions. Some pitchbooks to issuers described how analysts assisted investment banking efforts of the firm in preparing for an underwriting and assisting in marketing IPO securities. Issuers sometimes were told which analysts would be assigned to cover their companies and a list of that analyst's ratings for other companies.

93. Investment bankers had input into decisions regarding the initiation and termination of research coverage on particular issuers. At times, Research sought approval from investment bankers before dropping coverage and investment bankers suggested certain issuers that Research should be covering. In some instances, analysts dropped coverage of issuers without first having downgraded the rating.

94. Draft research reports and expected ratings sometimes were shared by analysts with investment bankers and issuers. In some cases, analysts made changes to draft research

reports after getting feedback from issuers. Investment bankers also had input into the hiring of Goldman Sachs analysts.

95. Goldman Sachs did not adequately monitor contacts between research and investment banking. In some cases, the supervisory procedures were not adequate. The procedures in place to monitor communications between analysts and investment bankers or covered companies were not adequate.

III.

CONCLUSIONS OF LAW

1. The Commission has jurisdiction over this matter pursuant to Article XV of the Arizona Constitution and the Securities Act.

2. Goldman Sachs:

   i. failed to ensure that analysts who issued research were adequately insulated from pressures and influences from covered companies and investment banking; and

   ii. failed to reasonably to supervise its employees to ensure that its analysts who issued research were adequately insulated from pressures and influences from covered companies and investment banking.

   This conduct was a dishonest or unethical practice, pursuant to A.R.S. §44-1961(A)(13).

3. GOLDMAN SACHS's conduct is grounds for administrative penalties under A.R.S.§ 44-1961(B)(1).

4. GOLDMAN SACHS's conduct is grounds for a cease and desist order pursuant to A.R.S. § 44-1961(B)(2).

5. GOLDMAN SACHS's conduct is grounds for an order requiring GOLDMAN SACHS to take affirmative action to correct the conditions and practices giving rise to this action pursuant to A.R.S.§ 44-1961(B)(3).

6. Nothing in this Order shall be construed as a finding or admission of fraud.

IV.

ORDER

On the basis of the Findings of Fact, Conclusions of Law, and GOLDMAN SACHS's consent to the entry of this Order, for the sole purpose of settling this matter, prior to a hearing and without admitting or denying any of the Findings of Fact or Conclusions of Law, the Commission finds that the following relief is appropriate, in the public interest, and necessary for the protection of investors.

THEREFORE, IT IS HEREBY ORDERED:

1. This Order concludes the investigation by the Commission and any other action that the Commission could commence under applicable Arizona law on behalf of Arizona as it relates to GOLDMAN SACHS, relating to certain research practices at GOLDMAN SACHS described herein.

2. Pursuant to A.R.S. § 44-1961(B)(2) and (3), GOLDMAN SACHS will CEASE AND DESIST from violating A.R.S. §44-1961(A)(13) in connection with the research practices referenced in this Order and will comply with the undertakings of Addendum A, incorporated herein by reference.

3. Pursuant to A.R.S. § 44-1961(B)(1), GOLDMAN SACHS shall pay an administrative penalty in the amount of $395,321.00.

4. If payment is not made by GOLDMAN SACHS or if GOLDMAN SACHS defaults in any of its obligations set forth in this Order, the Commission may vacate this Order, at its sole discretion, upon 10 days notice to GOLDMAN SACHS and without opportunity for administrative hearing.

5. GOLDMAN SACHS agrees that it shall not seek or accept, directly or indirectly, reimbursement or indemnification, including but not limited to payment made pursuant to any insurance policy, with regard to all penalty amounts that GOLDMAN SACHS shall pay pursuant to this Order or section II of the SEC Final Judgment, regardless of whether such penalty amounts or any part thereof are added to the Distribution Fund Account referred to in the SEC Final

Judgment or otherwise used for the benefit of investors. GOLDMAN SACHS further agrees that it shall not claim, assert, or apply for a tax deduction or tax credit with regard to any state, federal or local tax for any penalty amounts that GOLDMAN SACHS shall pay pursuant to this Order or section II of the SEC Final Judgment, regardless of whether such penalty amounts or any part thereof are added to the Distribution Fund Account referred to in the SEC Final Judgment or otherwise used for the benefit of investors. GOLDMAN SACHS understands and acknowledges that these provisions are not intended to imply that the Commission would agree that any other amounts GOLDMAN SACHS shall pay pursuant to the SEC Final Judgment may be reimbursed or indemnified (whether pursuant to an insurance policy or otherwise) under applicable law or may be the basis for any tax deduction or tax credit with regard to any state, federal or local tax.

6. This Order is not intended by the Commission to subject any Covered Person to any disqualifications under the laws of any state, the District of Columbia or Puerto Rico (collectively, “State”), including, without limitation, any disqualifications from relying upon the State registration exemptions or State safe harbor provisions. "Covered Person" means GOLDMAN SACHS, or any of its officers, directors, affiliates, current or former employees, or other persons that would otherwise be disqualified as a result of the Orders (as defined below).

7. The SEC Final Judgment, the NYSE Stipulation and Consent, the NASD Letter of Acceptance, Waiver and Consent, this Order and the order of any other State in related proceedings against GOLDMAN SACHS (collectively, the “Orders”) shall not disqualify any Covered Person from any business that they otherwise are qualified, licensed or permitted to perform under the applicable law of Arizona and any disqualifications from relying upon this state’s registration exemptions or safe harbor provisions that arise from the Orders are hereby waived.

8. The Orders shall not disqualify any Covered Person from any business that they otherwise are qualified, licensed or permitted to perform under applicable state law.

9. For any person or entity not a party to this Order, this Order does not limit or create any private rights or remedies against GOLDMAN SACHS including, without limitation, the use of any e-

mails or other documents of GOLDMAN SACHS or of others regarding research practices, or limit or create liability of GOLDMAN SACHS, or limit or create defenses of GOLDMAN SACHS to any claims.

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10. Nothing herein shall preclude Arizona, its departments, agencies, boards, commissions, authorities, political subdivisions and corporations, other than the Commission and only to the extent set forth in paragraph 1 above, (collectively, "State Entities") and the officers, agents or employees of State Entities from asserting any claims, causes of action, or applications for compensatory, nominal and/or punitive damages, administrative, civil, criminal, or injunctive relief against GOLDMAN SACHS in connection with certain research practices at GOLDMAN SACHS.

IT IS FURTHER ORDERED that this Order shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION

/s/ Marc Spitzer		William A. Mundell
CHAIRMAN	COMMISSIONER	COMMISSIONER
Jeffrey Hatch-Miller	Lowell Gleason	
COMMISSIONER	COMMISSIONER	

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Secretary of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this __29th_ day of _September__________, 2003.

_/s/ Brian C. McNeil____________________________
BRIAN C. McNEIL
Executive Secretary

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DISSENT

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DISSENT

This document is available in alternative formats by contacting Yvonne McFarlin, Executive Assistant to the Executive Secretary, voice phone number 602-542-3931, E-mail ymcfarlin@cc.state.az.us.

(PAH)

CONSENT TO ENTRY OF ADMINISTRATIVE ORDER BY GOLDMAN, SACHS & CO.

GOLDMAN, SACHS & CO. hereby acknowledges that it has been served with a copy of this Administrative Order, has read the foregoing Order, is aware of its right to a hearing and appeal in this matter, and has waived the same.

GOLDMAN, SACHS & CO. admits the jurisdiction of the Commission, neither admits nor denies the Findings of Fact and Conclusions of Law contained in this Order; and consents to entry of this Order by the Commission as settlement of the issues contained in this Order.

GOLDMAN, SACHS & CO. states that no promise of any kind or nature whatsoever was made to it to induce it to enter into this Order and that it has entered into this Order voluntarily.

Gregory K. Palm represents that he is a Managing Director and General Counsel of GOLDMAN, SACHS & CO. and that, as such, has been authorized by GOLDMAN, SACHS & CO. to enter into this Order for and on behalf of GOLDMAN, SACHS & CO.

Dated this _2nd_ day of _September_______, 2003.

GOLDMAN, SACHS & CO.

By: _/s/ Gregory K. Palm_________________
Gregory K. Palm
Title: Managing Director and General Counsel

SUBSCRIBED AND SWORN TO before me this __2nd day of ___September__________, 2003.

__/s/ Stephanie G. Wheeler___________________
Notary Public

My Commission expires:

__March 3, 2006________